

3.2 Basic Considerations

Composition of total costs. The total cost of a program is the sum of the allowable direct and indirect costs allocable to the program less any applicable credits. In ascertaining what constitutes costs, any generally accepted accounting method of determining or estimating costs that is equitable under the circumstances may be used.

Factors affecting allowability of costs. Factors to be considered in determining the allowability of individual items of cost include:

- (1) reasonableness,
- (2) allocability,
- (3) application of those generally accepted accounting principles and practices appropriate to the particular circumstances, and
- (4) any limitations or exclusions set forth in this document or otherwise included in the contract as to types or amounts of cost items.

Definition of reasonableness. A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person in the conduct of competitive business. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with institutions or separate divisions thereof which may not be subject to effective competitive restraints. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a given cost, consideration shall be given to:

- (1) whether the cost is of a type generally recognized as ordinary and necessary for the operation of the institution or the performance of the contract;
- (2) the restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and contract terms and specifications;
- (3) the action that a prudent businessman would take in the circumstances, considering his responsibilities to the public at large, the Government, his employees, his clients, shareholders or members and the fulfillment of the purposes for which the institution was organized; and
- (4) significant deviations from the established practices of the institution which may unjustifiably increase the contract costs.

Definition of allocability. A cost is allocable if it is assignable or chargeable to a particular cost objective, such as a contract, project, product, service, process, or other major activity, in accordance with the relative benefits received or other equitable relationship. Subject to the foregoing a cost is allocable to a Government contract if it:

- (1) is incurred specifically for the contract;
- (2) benefits both the contract and other work and can be distributed to them in reasonable proportion to the benefits received; or
- (3) is necessary to the overall operation of the institution, although a direct relationship to any particular cost objective cannot be shown.

Where an organization utilizes the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations (or comparable generally accepted accounting standards peculiar to its particular organizational structure or activity) to allocate costs to non-Government supported activities, it must also use such standards to allocate costs to Government contracts.

Applicable credits. The term applicable credits refers to those receipts or negative expenditure types of transactions which operate to offset or reduce expense items that are allocable to contracts as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances; recoveries or indemnities on losses; sales of scrap or incidental services; and adjustments of overpayments or erroneous charges. The applicable portion of any income, rebate, allowance, and other credit relating to any allowable cost, received by or accruing to the provider shall be credited to the Government either as a cost reduction or by cash refund, as appropriate.

Third-Party Liability. The term third-party refers to an individual, institution, corporation, or public or private agency that is liable to pay all or part of the medical cost of injury, disease, or disability for a client of the institution. Examples of third-party resources are:

- (1) Medicare
- (2) Railroad Retirement Act
- (3) Insurance policies (private health, group health, liability, automobile medical insurance, family health insurance carried by an absent parent)
- (4) Workman's Compensation
- (5) Veterans' Administration
- (6) CHAMPUS (Civilian Health and Medical Program of the Uniformed Services)

The applicable portion of any resulting income received by or accruing to the institution shall be credited to the Government by means of a cost reduction or cash refund, as appropriate.

Cost Objectives

For cost determination purposes, components of costs may be classified into two types: direct and indirect. This subsection addresses these two types of costs.

Direct Cost

A direct cost is any cost which can be identified specifically with a particular cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with the contract are direct costs of the contract and may be charged directly thereto. Costs identified specifically with other work of the institution are direct costs of that work and are not to be charged to the contract either directly or indirectly. Items charged as direct cost to Government-supported projects must be charged in a uniform manner to all other work of the institution in order to preclude an overcharge to the Government as a result of the Government's participation in the indirect cost pool.

Conversely, where the institution's established accounting system provides for the treatment of certain items of cost as direct costs of the institution, then the same items must be considered direct costs to Government-supported projects and may not be included in the indirect cost pool.

Certain types of cost, or costs associated with certain activities are not reimbursable as a charge to a Government contract. Examples of such unallowable costs or activities are identified in Section 3.6. Even though a particular activity or cost is designated as unallowable for purposes of computing costs charged to Government work, it nonetheless must be treated as a direct cost or activity if a portion of the institution's indirect cost is properly allocable to it. The amount of indirect cost allocated must be in accordance with the principles set forth below. In general, an unallowable institutional activity shall be treated as a direct function when it (1) includes salaries of personnel, (2) occupies space, and (3) is serviced by an indirect cost grouping(s). Thus the costs associated with the following types of activities when normal or necessary to an institution's primary mission shall be treated as direct costs:

- (1) Maintenance of membership rolls, subscriptions, publications and related functions.
- (2) Providing services and information to members, legislative or administrative bodies or the public.
- (3) Promotion, lobbying, and other forms of public relations.
- (4) Meetings and conferences except those held to conduct the general administration of the institution.

- (5) Fund raising.
- (6) Maintenance, protection, and investment of special funds not used in operation of institutions.
- (7) Administration of group benefits on behalf of members or clients including life and hospital insurance, annuity or retirement plans, financial aid, etc.
- (8) Other activities performed primarily as a service to a membership, clients, or the public.

This definition shall be applied to all items of cost of significant amount unless the institution demonstrates that the application of any different current practice achieves substantially the same results. Direct cost items of minor amount may be distributed as indirect costs as described below.

Indirect Costs

An indirect cost is one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost. Minor direct cost items may be considered to be indirect costs for reasons of practicality. After direct costs have been determined and charged directly to the contract or other work as appropriate, indirect costs are those remaining to be allocated to the several classes of work. The overall objective of the allocation process is to distribute the indirect costs of the institution to its various major activities or cost objectives in reasonable proportions with the benefits provided to those activities or cost objectives. Because of the diverse natures and purposes of organizations it is impractical to specifically identify those functions which constitute major activities for purposes of identifying and distributing indirect costs. Such identification will be dependent upon an institution's purpose-in-being, the services it renders to the public, its clients and/or members, the amount of effort devoted to fund raising activities, public relations, and membership activities, etc., as explained under Direct Costs above.

Indirect cost shall be accumulated by logical cost groupings with due consideration of the reasons for incurring the costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Sub-grouping may be required where there is no single equitable distribution base for all the elements of cost comprising a group. Actual conditions must be taken into account in selecting the method or base to be used in distributing the expenses assembled under each of the objectives. Where a distribution can be made by assignment of a cost grouping directly to the area benefited, the distribution should be made in that manner. Where the expenses under a cost grouping are more general in nature, the distribution to the cost objectives should be made through use of a selected base which will produce results which are equitable to both the Department and the institution. In general, any cost element or cost-related factor associated with the institution's work is potentially adaptable for use as a distribution base provided (1) it can readily be expressed in terms of

State of New Jersey

Department of Human Services
(Rev. May 1987)

TN No. 89-1
supersedes
TN No. 80-2

Approval Date: 2/23/90
5

Effective Date: 10/1/89
89-1-MA (NJ)

dollars or other quantitative measure (total direct expenditures, direct salaries, man-hours applied, square feet utilized, hours of usage, number of documents processed, population served, and the like); and (2) it is common to the cost objectives during the base period. The essential consideration in selection of the distribution base in each instance is that it be the one best suited for assigning the pool of costs to the objectives in accord with the relative benefits derived, the traceable cause and effect relationship, or logic.

The number and composition of the groupings should be governed by practical considerations and should be such as not to complicate unduly the allocation where substantially the same results are achieved through less precise methods.

A base period for distribution of indirect costs is the period during which such costs are incurred and accumulated for distribution to work performed within that period. The base period normally should coincide with the fiscal year established by the institution, but in any event the base period should be so selected as to avoid inequities in the distribution of costs.

Indirect Cost Pools

Subject to the following paragraphs, indirect costs allocable to an institution's direct functions should be treated as a common pool, and the costs in such common pool should then be distributed to the individual projects benefiting therefrom by use of a single rate.

In some instances a single rate for use across the board on all activities at an institution may not be appropriate, since it would not take into account those different environmental factors which may affect substantially the indirect costs applicable to a particular segment of work at the institution. For this purpose, a particular segment of work may be that performed under a single contract or it may consist of work under a group of contracts performed in a common environment. The environmental factors are not limited to the physical location of the work. Other important factors are the level of the administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. Where a particular segment of work is performed within an environment which appears to generate a significantly different level of indirect costs, provision should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular distribution process, and the separate indirect cost rate resulting therefrom should be utilized provided it is determined that (1) such indirect cost rate differs significantly from that which would have been obtained under a common pool as stated above and (2) the volume of work to which such rate would apply is material in relation to other activity at the institution.

TN No. 89-1
supercedes
TN No. 80-2

Approval Date: 2/23/90
Effective Date: 10/1/89

The Distribution Base

Indirect costs should be distributed to each applicable project on the basis of direct salaries and wages, total direct costs or other basis which results in an equitable distribution. For this purpose, an indirect cost rate should be determined for a single or each of the separate indirect cost pools. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the base selected.

3.4 SELECTED ITEMS OF COSTS

Application of Principles and Procedures

Costs shall be allowed to the extent that they are reasonable, allocable, and determined to be allowable in view of the factors set forth in Section 3.2. These criteria apply to all of the selected items of cost which follow notwithstanding that particular guidance is provided in connection with certain specific items for emphasis or clarity.

Cost under any subcontracts entered into by the institution are subject to the same cost regulations and policies as the institution.

Selected items of cost are listed in the following sections entitled General Standards for Allowable Costs. It should be noted that not every element of cost nor every situation that might arise is covered. Failure to list any item of cost is not intended to imply that it is either allowable or unallowable. With respect to all items, whether or not specifically covered, determination of allowability shall be based on the principles and standards set forth in this document and, where appropriate, the treatment of similar or related selected items.

Selected Items of Cost

Subsections 3.5 and 3.6 provide standards to be applied in establishing the allowability of certain items involved in determining costs. These standards should apply irrespective of whether a particular item of cost is properly treated as direct cost or indirect cost. In case of a discrepancy between the provisions of a specific contract and the applicable standards provided, the provisions of the contract shall govern. Under any given contract the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with nonprofit institutions which are so diverse in nature and not subject to effective competitive restraints. In order to avoid possible subsequent disallowance or dispute based on unreasonableness or nonallocability, it is important that institutions entering into contracts with the Government seek agreement in advance of the incurrence of special or unusual costs in categories where reasonableness or allocability are difficult to determine. Such action may also be initiated by the Government. Examples of costs on which advance agreements may be particularly important are:

- (1) Compensation for personal services
- (2) Consultant fees
- (3) Deferred maintenance costs
- (4) Excess facility costs
- (5) Material, services, and supplies sold between organizations or divisions under common control

- (6) Pre-award costs
- (7) Publication and public information costs
- (8) Royalties
- (9) Training and educational costs
- (10) Travel costs, as related to special or mass personnel movement, and to the class of air-travel accommodations allowable
- (11) Negotiated use allowance for fully depreciated assets
- (12) Depreciation or use charge on assets donated to the institution by third parties

3.5 ALLOWABLE ITEMS OF COST

	<u>Page</u>
1. Advertising Costs	11
2. Bidding or Proposal Costs	11
3. Bonding Costs	11
4. Civil Defense Costs	12
5. Compensation for Personal Services	12
6. Depreciation and Use Allowances	18
7. Employee Morale, Health, Welfare Costs	21
8. Fringe Benefits	22
9. Insurance and Indemnification	22
10. Labor Relations Costs	23
11. Maintenance and Repair Costs	24
12. Materials Costs	24
13. Other Business Expenses	25
14. Overtime, Extra-Pay Shift and Multi-Shift Premiums	25
15. Pension Plans	26
16. Plant Protection Costs	26
17. Professional Service Cost - Legal, Accounting Scientific and Other	26
18. Rearrangement and Alteration Costs	27
19. Recruitment Costs	27
20. Relocation Costs	28
21. Rental Costs	29
22. Severance Pay	30
23. Taxes	30
24. Termination Costs	31
25. Trade, Business, Technical, and Professional Activity Costs	33
26. Training and Educational Costs	33
27. Transportation Costs	34
28. Travel Costs	34
29. Clothing Costs	35.1

OFFICIAL

TN

90-18

OCT 22 1998

Supervisor

89-1

4-1-90

General Standards for Allowable Costs

1. Advertising Costs

- a. Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazine, newspapers, radio, and television programs, direct mail, trade papers, outdoor advertising, dealer cards, and window displays, conventions, exhibits, free goods, and samples, and the like.
- b. The only advertising costs allowable are those which are solely for:
 - (1) the recruitment of personnel required for the performance by the institution of obligations arising under the contract, when considered in conjunction with all other recruitment costs (as set forth in Item 19)
 - (2) the procurement of scarce items for the performance of the contract; or
 - (3) the disposal of scrap or surplus materials acquired in the performance of the project. Costs of this nature, if incurred for more than on Government award or for both Government work and other work of the institution, are allowable to the extent that the principles in Section 3.2 and 3.3 are observed.

2. Bidding or Proposal Costs

Bidding or proposal costs are the immediate costs of preparing bids or proposals on potential Government and non-Government contracts or projects. Bidding costs of the current accounting period are allowable as part of the indirect cost pool. Costs of past accounting periods are unallowable. Bidding costs do not include any of those costs described in Item 13.

3. Bonding Costs

- a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the contractor. These costs arise also in instances where the contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.
- b. Costs of bonding required pursuant to the terms of the contract are allowable.
- c. Costs of bonding required by the contractor in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.